

AR43

FATHOM

OCEANOLOGY LIMITED

1972

ANNUAL REPORT

FOR THE YEAR ENDED MARCH 31 1972

Directors

- *K. R. OLSEN, Hudson, Quebec.
President, Fathom Oceanology Limited,
Vice President,
Atlas Construction Limited.
- *R. L. I. FJARLIE, Maxville, Ontario.
Executive Vice President,
Fathom Oceanology Limited.
- *N. E. HALE, Mississauga, Ontario.
Vice President Administration —
Research and Development,
Fathom Oceanology Limited.
- S. W. ARMSTRONG, Calgary, Alberta.
President, Canam Holdings Limited.
- W. A. DOW, West Vancouver,
British Columbia.
President, Ritchie Services Limited.
- *J. B. FOOTE, Markham, Ontario.

Officers

- K. R. OLSEN,
President
- R. L. I. FJARLIE,
Executive Vice President
- N. E. HALE,
Vice President
- K. GARDNER,
Vice President
- J. O. EMPEY,
Vice President
- B. G. CRANE,
Controller
- R. A. DONALDSON,
Secretary

Head Office and Plant

863 Rangeview Road, Port Credit, Ontario.

Subsidiary Company

Hale and Associates Limited,
Port Credit, Ontario.

Transfer Agent and Registrar

National Trust Company Limited,
Toronto, Ontario and Calgary, Alberta.

Banker

Bank of Montreal, Toronto, Ontario.

Auditors

Clarkson, Gordon and Company,
Toronto, Ontario.

Legal Council

Blake, Cassels and Graydon,
Toronto, Ontario.

The annual meeting of the shareholders of Fathom Oceanology Limited will be held in the Algonquin Room of the Royal York Hotel, Toronto at 2:00 P.M. on the 27th day of September 1972.

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PRESIDENT'S ADDRESS
ON THE OCCASION OF THE
ANNUAL SHAREHOLDERS' MEETING
SEPTEMBER 27, 1972

Lee

As most of you will know, Fathom Oceanology Limited is a relatively young company. We are in fact a little under four years old. Our business is the design, sale and manufacture of a system that permits the launching, towing and recovery by ships at sea of equipment used for underwater intelligence in one form or another.

The system is made up of a towed body to house the intelligence equipment, a faired cable to attach it to the towing vessel, and a piece of deck-mounted machinery for launching and recovery. There are no other systems made that can match our performance.

Although we have held three previous Shareholders' Meetings, as of course we are required to do by law, this is the first at which we have attempted to provide our shareholders with more than the minimum requirements of the law.

For nearly four years we have been working to design, sell and make our product, but we have been guilty, and no doubt unwise, in neglecting to provide our shareholders with a flow of information about our progress.

While our troubles, most of which are financial, are far from over, we have reached a point in our life where the clouds are beginning to clear.

As you will have learned from our Annual Report, our customers are very large important people in Canada, The United States, Sweden, Brazil, and other parts of the world. These people have an urgent need for what we have to sell, and have shown far more than a casual interest in doing business with us.

After months of examination and countless journeys across the world by both their staff and ours, some of them have ordered trial systems or components. So far we have delivered 3 major systems, and all have come up to expectations. In fact, some customers have expressed pleased surprise that our promise of performance has been so well kept.

One might say that most of the systems we have sold so far have been trial systems. The customers ordered one to see if it worked. Having convinced themselves that it did, they are now talking in terms of additional systems.

The problem for us is that we are dealing with enormous customers planning huge expenditures, of which our system is only a small part. It therefore takes a long time for budgets to be approved and negotiation to develop into orders.

The two most important completed contracts of the last year have been for Texaco and the Government of Sweden. It was Texaco's second system and is now in use, as far as we know, somewhere off the coast of Alaska. It is being used for hydro-carbon sniffing on the ocean floor. The high confidential nature of the work does not permit much feed back other than that our part is doing its job.

The system for the Government of Sweden was delivered in June and is being used by the Swedish Navy for intelligence purposes. Mr. Hale, Mr. Fjarlie and Mr. Empey, who are here today, spent a week on a Swedish military vessel in the Baltic while the system underwent its sea trials. It was accepted without modification or adjustment of any kind. Those of you who are interested will find the account of the trials very enlightening, and you may wish to discuss it with Messrs. Hale, Fjarlie or Empey after the formalities of this meeting are over.

The highly satisfactory conclusion to the Swedish trials have really brought Fathom to the end of what one might identify as the second stage in the company's development.

The first stage was the expensive R & D stage. We were developing the product and had little or no source of income.

The second stage was the sale, manufacture and delivery of trial units to both military and commercial customers. Here we had heavy expenditures but a better source of income.

We are now at the point where our satisfied customers are making plans for the more extensive use of our equipment. Designs for vessels are complete, and in many cases production has begun. Our system is required during the fitting stage, and we are going to have to wait on the customer's time for his order.

This waiting is tiresome but a fact of corporate life, and we may have to be patient for several months. In the meantime our largest single contract to-date, with EDO Corp. -- two systems for the Brazilian Navy -- is proceeding to the tooling and manufacturing stage.

Other developments are taking place that will serve us well. Our product is essentially an underwater towing system that permits far greater speeds than have ever before been possible. While it was originally developed with sonar apparatus in mind, it does open up many other possibilities, of which hydro-carbon sniffing is one. It can, and is, being used experimentally to tow T.V. systems for visual surveillance and search. This could open broader market opportunities.

Another interesting application is on submarines. The need here is to launch and tow upwards toward the surface. Until now submarines have had to slow down to permit the towing of antenna for radio communication. Now, with the use of Fathom faired cable and launching principles, high speed antenna towing is possible. From a military point of view, this is a much safer condition.

Another possible development is also in the upward towing of radar scanners. These would permit the area to be scrutinized without forcing the vessel to slow down or surface.

High speed towing systems for hydrofoil and hovercraft vessels are presently being contemplated. Fathom, today, has the technology and products to meet all these requirements. No doubt other developments will follow.

As these various applications become fact, more and more faired cable will be in use. Each cable needs anything up to 20,000 feet of Fathom fairings. Therefore, a considerable after-market exists for replacement fairings, as each cable has a life span of little more than three years. The fairing design is covered by Fathom patents, and it can only be acquired from us. As I told you before, our future prospects are enormous. We must stay fit and well to meet them.

Now I must comment on our financial affairs. As you know, we are not yet in a profitable position. Enormous amounts of money have had to be spent on design and development; equipping a plant and offices in Port Credit; installing testing facilities, and purchasing labour and materials.

We had some very heavy bills to pay in fiscal 1971 which resulted in a deficit of some \$264,000. Last fiscal year we made a considerable step forward by cutting the deficit for the year to less than \$100,000.

I do not propose to forecast how the year will end, but the line is moving rapidly to the break-even point. Our operating revenue rose 36% in 1971 over 1970, and the promise of the future is good. Our backlog at the end of March was over half a million dollars.

The horizons are continuously growing larger and brighter for Fathom. The marketing and advertising exposure of the company by Don Rowton and Ken Gardner have made our name and technology known in many countries the world over. The "feed back" from many of these contacts has been both respectful and encouraging. The teamwork of the organization has been a very decisive factor in our improving image. The ingredients are now present in your company to make it a highly successful venture in a new and exciting market, the oceans of the world.

K. R. Olsen, P.Eng.
President

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In August our order from the United States Navy was delivered and awaits its sea trials. Our marketing program continues to be very aggressive and we are in constant touch with the most important prospects. No fewer than fourteen nations and ten large international companies have sought information on our system. The value of bids outstanding amounts to approximately twelve million dollars. We continue to pursue every opportunity.

Not only is our product of great interest to those involved in oceanology, but our technical expertise is also being recognized. In October of this year we accepted an invitation to present a paper on deep sea towing for exploration purposes at the Second International Ocean Development Conference in Tokyo. Since then, we were invited and joined a scientific industrial mission to West Germany sponsored by the Department of Industry, Trade & Commerce in Ottawa. This recognition augments our own marketing efforts and gives us very valuable additional exposure to important potential clients.

Haare Olsen.

K. R. Olsen, P. Eng.
President.

December 5, 1972.

FATHOM
OCEANOLOGY LIMITED



SEMI-ANNUAL REPORT
TO SHAREHOLDERS
(UNAUDITED)

FOR SIX MONTHS ENDED
SEPTEMBER 30, 1972



TO THE SHAREHOLDERS

Loss for the six month period ended September 30, 1972 was \$32,758 or 3 cents per share. This compared with a loss of \$229,903 or 19 cents per share for the corresponding period a year ago. Revenue was \$373,206 compared with \$183,000 reported last year.

Funds applied to operations were \$4,308 compared with \$213,202. This enormous improvement was achieved by cutting administrative overhead charges by some thirty percent and by substantially increased revenues.

During the period, the Ontario Development Corporation expressed its confidence in your management and the Company's future prospects by advancing a \$100,000 working capital loan. This government agency also indicated its willingness to extend a further line of credit to the limit of \$150,000 to finance future export sales if and when the need arises.

Considerable progress continues to be made in the effort to bring the Company into a profitable position. At the end of our 1971 financial year we reported a loss of \$264,000. A year later this loss had been reduced to \$95,000. Now, halfway through the present financial year, we are able to report that we have reduced this figure to \$33,000. The value of orders on hand at October 1, 1972 was \$727,300.

In July we delivered a system to the Swedish Government which has since undergone successful acceptance trials.

FATHOM OCEANOLOGY LIMITED

(Incorporated under the laws of Canada)

Consolidated Statement of Operations

For the Six Months Ended September 30th, 1972

with comparative figures for the Six Months Ended September 30th, 1971

	1972	1971
Revenue	373,206	183,000
Gross earnings (loss)	93,066	(44,320)
Administrative and selling expense	125,824	185,583
Net loss	32,758	229,903
Loss per share	\$0.03	\$0.19

Consolidated Statement of Changes in Financial Position

For the Six Months Ended September 30th, 1972

with comparative figures for the Six Months Ended September 30th, 1971

FUNDS WERE RECEIVED FROM:

Proceeds from ODC loan	100,000	—
Proceeds from 12% convertible bonds	—	85,000

FUNDS WERE APPLIED TO:

Operations	32,758	229,903
Net loss for the period	—	—
Less charges to operations not involving an outlay of working capital, depreciation and amortization	28,450	16,701
Funds applied to operations	4,308	213,202
Reduction in long term debt	6,385	—
Purchase of fixed assets	3,737	41,873
Cost of patents	5,915	1,559
Other	—	50
Total funds applied	20,345	256,684
INCREASE (DECREASE) IN WORKING CAPITAL	79,655	(171,684)
WORKING CAPITAL (DEFICIENCY)		
Beginning of period	37,978	(18,621)
End of period	\$117,633	\$ (190,305)

FATHOM OCEANOLOGY LIMITED

(Incorporated under the laws of Canada)

To the Shareholders of Fathom Oceanology Limited

Summary of Results

The financial position improved considerably in fiscal 1972. Although the company must report a loss of \$95,000 or 9 cents a share, this compares favourably with a loss of \$264,000 or 27 cents a share in the previous year. Grants from the Government of Canada through the Industrial Research & Development Incentives Act (IRDIA) and the Defence Industry Productivity program (DIP) are included in the result. Operating revenue rose thirty-six percent to \$425,000 from \$312,000 reported in 1971. The value of work on hand at April 1, 1972 amounted to \$650,000.

Product Acceptance

The last twelve month period has been very significant for our company. We have yet to overcome our financial difficulties but we have made some very important progress in the area of product acceptance by the customer.

While the towing of bodies as a source of undersea intelligence is not entirely new, Fathom technology has developed a product that has reduced the size and cost of the equipment to a point where other than the military can entertain its use. Its commercial application is thus receiving serious consideration in many quarters. To date this has been mainly in the field of oil exploration and hydrographic survey. Military interests are still vitally concerned particularly as its use on small ships and patrol craft can now be considered.

The customers with whom we are doing business are either very large international enterprises or governments. It has taken them a long time to become convinced of the quality of our product. They move slowly and with caution but they move very surely. They insist on the most exhaustive examination of all the factors and then order trial units.

The System. If the body in this drawing were launched, it would rotate anti-clockwise into the water through approximately 200 degrees and remain attached to the towing cable.

What we have supplied so far has satisfied this trial. Several units have been delivered and put through their paces and it is a great source of pride to the staff of our company that the product has been so well accepted.

Completed Contracts

Of the contracts completed during the year, our most significant was a complete system for Texaco. This was their second Fathom unit, the first having been delivered a year earlier. Other contracts included the supply of several thousand Flexnose* fairings. These fairings, the design of which is a Fathom patent, are used to stabilize the behaviour of the towing cable in water and reduce drag. They are a consumable item since the cables to which they are fitted have a relatively limited life (2 to 3 years) in the salt water environment. Customers were: Texaco; Gulf Oil; the Defence Research Establishment Atlantic; Bedford Institute of Oceanography; the Canada Centre for Inland Waters; and the Royal Canadian Navy.

Work in Progress

Total value of work in progress at the close of the financial year amounted to \$650,000. Much of this is represented by a contract

*Registered Name

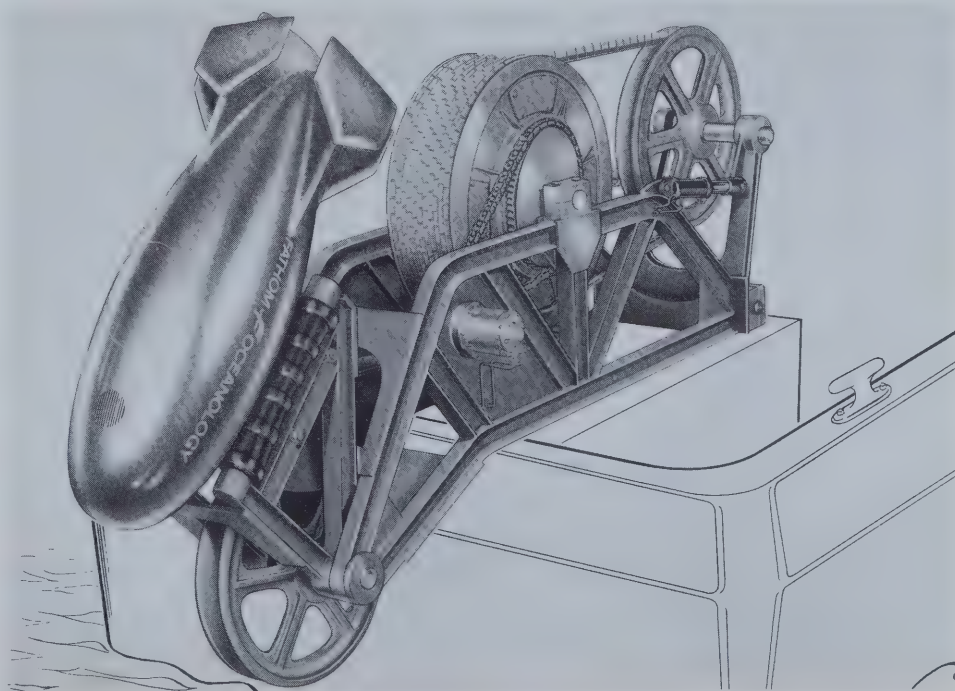
with Edo Corporation in the United States for two systems for the Government of Brazil, and to a lesser extent a military system for the Government of Sweden.

Also of significance is a contract from the United States Navy for the supply of a trial faired cable. While the dollar value of this contract is not large, its success in meeting the customer's requirements has an obvious and attractive potential for future business.

Future Opportunities

The future opportunities for business are enormous. All naval vessels engaged in defense need towed sonar. Up until now only the large vessels could carry the equipment and in a recent survey we found that fewer than ten percent were fitted. Talks with our own Government and those of other countries have assured us of their interest in our equipment, not only for new vessels but for some that are already afloat.

Exploration of the ocean floor has increased in recent years and huge sums of money are being spent by commercial operators and governments. Several Fathom units are already in service in this area and their excellent performance promises well for the future.



Fathom representatives are spending much of their time in Ottawa, Washington and overseas following up an ever-increasing interest that is being shown by customers at the very highest levels.

Financial Problems

While the examination and subsequent approval of our products by our important customers is very encouraging, the time it takes exacts a serious burden on our treasury. We have been operating as a company for only forty months and our struggle to maintain financial equilibrium has been a major concern.

In a company as small as Fathom very highly talented people are expensive to retain in all departments and yet, that is what we need. The skill of our technical people is beyond question. If it were not so we would not exist. Our concern lays in fiscal management.

To overcome this problem we retained the services of first class outside council and in the few months they have applied their energies to our problems, the picture has changed.

A further and quite recent endorsement of confidence has come to us from both the Federal Government of Canada and the Provincial Government of Ontario. In consequence, we are receiving development loans and lines of credit on export contracts which in total will amount to nearly one million dollars. They gave us fair examination and their grant is a confirmation of our skill, stability and future prospects.

Capital Expenditures

Capital expenditures during the year amounted to \$113,000. A large part of this was applied to the construction and installation in our plant in Port Credit of a floodable ship-ocean simulator. Each system built must be trial operated under as near practical working conditions as possible, and the facility enables us to go through trial launching and recovery cycles, as well as permitting dynamic and static cable loading tests.

It is one of the most advanced simulators of its kind, built specifically for the testing of towing systems and has already proved its worth in avoiding expensive adjustments on trials at sea.



K. R. Olsen — President (right) and R. L. I. Fjarlie — Executive Vice President.

Research and Development

An ongoing program of research and development is vital to our continued well-being. Fathom designs are well protected by patents and we continue to have reason to believe that our position is several years ahead of competition. Nevertheless, we cannot expect to remain alone in the business and a sound, well directed program of continued research and development geared to our resources is necessary if we are to maintain our lead. It is in this area particularly that the financial assistance of the Federal Government's development program has been, and continues to be, of great assistance to us.

Our patents are one of our most important assets. They are strong and registered in all major countries. A recent independent appraisal by General Appraisal Corporation of Milwaukee, placed a conservative value of \$400,000 on our patents when related to Fathom business. During the year, a new generation of designs was developed and application for patent protection has been made. It is a continuing process.

Staff

Twenty-seven people operate our Company. It is very important that we maintain only those who are essential to our progress. As we have moved forward, it has been necessary to group around us for limited periods people of differing

skills. In the early stages when designs were being developed and patents sought, the lawyer was very much in evidence. Later, when we moved to become a public company, those skilled in corporate assembly were our leaders. In what might be identified as the third stage of development, we needed negotiators to reach major customers in Canada and other parts of the world. We have been successful in attracting those whose skills we needed at each stage.

This year, Mr. John Rosseel, our second President, retired from the Company to pursue other interests. He had led us successfully to the threshold of what promises to be a period of sustained growth. It will be the responsibility of the present leadership to maintain corporate stability and to develop an environment for this growth to flourish. Fathom is well founded. Its staff is highly qualified. Hard work will bring further successes.

The Directors would like to thank all employees for their diligence, loyalty and enthusiasm, without which the promise of the past year would not have been possible.

By Order of the Board of Directors,

K. R. Olsen

K. R. Olsen
President

History of the Company

Fathom is a young company. It was incorporated in December of 1968. It is expected that many people who have never heard of Fathom will want to know how it came into being as one stage in the evaluation of its merit, for whatever happens to be their special interest. It is for their benefit that this history has been prepared.

Its Business

Fathom Oceanology Limited is principally engaged in the business of designing and building towed sonar systems that are used as a source of undersea intelligence by oceanographic, commercial and military organizations. Their systems are a highly efficient development of a long known practice and are heavily protected by design patents.

To be more specific, they manufacture a piece of machinery that is attached to the deck on the after end of a ship. This piece of machinery is capable of launching and recovering a hollow fish-like body under the surface of the sea which is towed along by means of an attached cable. The body usually contains electronic equipment and is capable of 'listening' to what is going on, and transmitting the information to the surface

vessel. In some cases, the body is fitted with equipment that will take samples of water and pump them to the surface via a hose within the towing cable.

Its Origin

The whole idea was originally developed, long before Fathom came along, to meet the military need for submarine detection. It was a refinement of sonar domes or electronic equipment that hitherto had been a fixed bump on the bottom of a ship's hull with no facility to make it remote from the vessel itself.

The first variable depth sonar developed in Canada was by the Royal Canadian Navy and Canadian Vickers Limited of Montreal, and was known as 'System 504'.

In 1962 the Canadian Government launched a new program to build a better system. It was known as 'System 505'.

Four companies were involved in its development. Canadian Westinghouse and Edo (Canada) Limited on the electronics; Fleet Manufacturing Limited on the mechanical deck equipment and a consulting engineering group doing business under the name of Hale and Associates Limited who was given the job of developing the towed body and designing the electro-hydraulic controls of the deck equipment. System 505 was

a big step forward and subsequently went into production to equip R.C.N. vessels.

Hale and Associates was not directly involved in the System 504, although it was retained to write the technical manuals and the trouble-shooting procedures.

Its Formation

The experience gained particularly on the System 505 led Hale and Associates to develop the basic principles of the system which is now the main product of Fathom Oceanology Limited. The basic philosophy was to simplify the complex approach presently in use, reduce the size and lower the enormous cost. The Fathom system in its conceptual form was introduced to a number of authorities in various countries, particularly those using small ships. With interest aroused, especially in Sweden, it was decided in December 1968 that Fathom Oceanology Limited would be formed to manufacture this new system. Hale and Associates Limited subsequently became the engineering arm and a subsidiary of Fathom.

N. E. Hale — Vice President, Administration —
Research and Development,
J. O. Empey — Vice President, Manufacturing,
K. Gardner — Vice President,
Application Engineering.



FATHOM OCEANOLOGY LIMITED

(Incorporated under the laws of Canada)

Consolidated Balance Sheet with comparative figures

Assets

	1972	1971
CURRENT ASSETS:		
Deposit receipt	—	\$ 50,000
Accounts receivable (notes 2 and 8 (a))	\$142,024	92,161
Grant receivable from Government of Canada (note 4 (a))	62,565	—
Estimated I.R.D.I.A. grant (note 4 (b))	35,000	—
Costs and estimated earnings in excess of billings on uncompleted contracts (note 3)	94,450	46,860
Income taxes recoverable	—	486
Inventory, at lower of cost and net realizable value	15,241	11,823
Prepaid expenses and travel advances	7,837	3,100
Total current assets	<u>357,117</u>	<u>204,430</u>
FIXED ASSETS (note 11)	<u>113,032</u>	<u>70,827</u>
OTHER:		
Patents and patents pending, at amortized cost (note 3)	74,245	75,816
Completed engineering designs, at nominal value	1	—
Rent deposits	10,238	10,188
Incorporation expense	—	1,749
Total other assets	<u>84,484</u>	<u>87,753</u>
Total assets	<u>\$554,633</u>	<u>\$363,010</u>

On behalf of the Board:

K. R. OLSEN, Director

N. E. HALE, Director

(See accompanying notes to Consolidated Financial Statement)

Sheet at March 31, 1972
Statements at March 31, 1971

Liabilities

CURRENT LIABILITIES:	1972	1971
Bank indebtedness (notes 2 and 8 (a))	\$129,198	\$ 74,473
Accounts payable and accrued charges	158,518	124,035
Due to shareholder	—	20,000
12% note payable (note 5)	25,000	—
Employee income and other taxes payable	6,423	4,543
Total current liabilities	319,139	223,051
NON-CURRENT LIABILITIES:		
12% convertible notes payable (notes 5 and 8 (a))	175,350	—
Due to shareholders (note 5)	14,850	—
Total non-current liabilities	190,200	—
MINORITY INTEREST (note 7 (b))	12,480	12,480

Shareholders' Equity

Share capital (note 6) —		
Authorized:		
2,000,000 common shares without nominal or par value		
Issued:		
1,181,667 common shares	512,622	512,622
Deficit	(479,808)	(385,143)
Total shareholders' equity	32,814	127,479
Total liabilities and shareholders' equity	\$554,633	\$363,010

Auditors' Report

To the Shareholders of
FATHOM OCEANOLOGY LIMITED:

We have examined the consolidated balance sheet of Fathom Oceanology Limited and its subsidiary as at March 31, 1972, and the consolidated statements of operations and deficit and changes in financial position for the year then ended. Our examination included a general review of the accounting procedures and such tests of accounting records and other supporting evidence as we considered necessary in the circumstances.

In our opinion these consolidated financial statements present fairly the financial position of the company as at March 31, 1972, the results of their operations and the changes in their financial position for the year then ended, in accordance with generally accepted accounting principles applied on a basis consistent with that of the preceding year.

Toronto, Canada
August 14, 1972.

CLARKSON, GORDON & COMPANY
Chartered Accountants

FATHOM OCEANOLOGY LIMITED

(Incorporated under the laws of Canada)

Consolidated Statement of Operations and Deficit

For the year ended March 31, 1972
with comparative figures for 1971

	1972	1971
REVENUE	<u>\$424,850</u>	<u>\$312,218</u>
GRANT FROM GOVERNMENT OF CANADA (D.I.P. PROGRAM) (note 4 (a))	<u>311,169</u>	<u>—</u>
DIRECT COSTS:		
Salaries and wages	229,710	139,124
Materials	208,603	67,129
Depreciation and amortization	35,329	13,083
Travel	5,246	16,450
Miscellaneous	<u>16,144</u>	<u>8,903</u>
	<u>495,032</u>	<u>244,689</u>
ADMINISTRATIVE, SELLING AND GENERAL EXPENSES:		
Administrative expenses	183,560	135,927
Selling and advertising	52,803	74,316
Management salaries	57,334	46,129
Consulting fees	28,582	20,958
Rent	29,510	20,176
(Recovery of) provision for doubtful accounts	(8,584)	25,000
Depreciation and amortization	5,709	8,542
Interest expense — short-term (net)	14,126	560
— long-term	<u>7,612</u>	<u>—</u>
	<u>370,652</u>	<u>331,608</u>
ESTIMATED COST RECOVERY UNDER I.R.D.I.A. PROGRAM (note 4 (b))	<u>35,000</u>	<u>—</u>
NET LOSS FOR THE YEAR	94,665	264,079
DEFICIT, BEGINNING OF YEAR	<u>385,143</u>	<u>121,064</u>
DEFICIT, END OF YEAR	<u>\$479,808</u>	<u>\$385,143</u>
NET LOSS PER SHARE	<u>\$.09</u>	<u>\$.27</u>

Consolidated Statement of Changes in Financial Position

For the year ended March 31, 1972
with comparative figures for 1971

	1972	1971
FUNDS WERE RECEIVED FROM:		
Proceeds from issue of 12% convertible notes payable (note 5)	\$200,350	—
Proceeds from D.I.P. grant for fixed assets (note 4 (a))	30,279	—
Transfer of shareholders' loans to non-current liabilities (note 5)	14,850	—
Proceeds from disposal of fixed assets	3,755	—
Common shares issued for cash less share issue expense of \$31,447	—	\$311,622
Total funds received	<u>249,234</u>	<u>311,622</u>
FUNDS WERE APPLIED TO:		
Operations —		
Net loss for the year	94,665	264,079
Less charges to operations not involving an outlay of working capital —		
Depreciation and amortization of fixed assets	37,181	20,825
Amortization of patents and patents pending	3,857	—
Loss on disposal of fixed assets	—	800
Other	1,785	428
Funds applied to operations	<u>51,842</u>	<u>242,026</u>
Transfer of 12% note to current liabilities	25,000	—
Purchase of fixed assets	113,456	74,038
Cost of patents and patents pending (net)	2,287	3,013
Other	50	600
Total funds applied	<u>192,635</u>	<u>319,677</u>
INCREASE (DECREASE) in working capital	<u>56,599</u>	<u>(8,055)</u>
WORKING CAPITAL (DEFICIT), beginning of year	<u>(18,621)</u>	<u>(10,566)</u>
WORKING CAPITAL (DEFICIT), end of year	<u>\$ 37,978</u>	<u>\$ (18,621)</u>
REPRESENTED BY:		
Current assets	\$357,117	\$204,430
Current liabilities	319,139	223,051
	<u>\$ 37,978</u>	<u>\$ (18,621)</u>

(See accompanying notes to Consolidated Financial Statement)

Notes to Consolidated Financial Statements March 31, 1972

1. Principles of consolidation

The consolidated financial statements include the accounts of Fathom Oceanology Limited and its partially-owned subsidiary Hale & Associates Limited from the date of acquisition on May 1, 1969.

2. Bank indebtedness

The bank loan is secured by a general assignment of book debts and by a chattel mortgage on the equipment of the company. Reference is made to note 8(a).

3. Accounting practice

The general practice followed by the company for contract work is to record profits on contracts in progress by the percentage of completion method, giving full recognition to losses when they become known. In the case of contracts extending over one or more years, revisions in cost and profit estimates, which can be significant, are reflected in the accounting period in which the relevant facts become known.

The accounting practice followed by the company for research and development costs, excluding costs of patents and patents pending, is to expense these items in the year. The company amortizes the cost of patents and patents pending in a systematic manner.

4. Research and development

- (a) On February 24, 1972 the company contracted with the Government of Canada under the D.I.P. program to continue the design and development of its towing systems. It agreed to contribute 50% of defined expenditures by the company on this project. The company is required to complete the project before July 1974. Under the terms of the contract the amount contributed by the Government shall not exceed \$602,500, of which \$311,169 (in respect of operating costs) has been reflected in the statement of operations and \$30,279 (in respect of fixed assets) has been reflected as a reduction in the cost of fixed assets on the balance sheet. While the Government is contributing these funds, in certain circumstances it can require partial or complete repayment of the grant. With Government approval the company, rather than repaying the grants can reinvest the funds in future development projects.
- (b) The accompanying financial statements reflect an estimated grant of \$35,000 from the Government of Canada for research and development expenditures under the Industrial Research and Development Incentives Act (I.R.D.I.A.).

5. 12% convertible notes payable

During the year the company issued 12% convertible notes for a total cash consideration of \$200,350. The notes, except for one note for \$25,000 with a callable option that was exercised on March 1, 1972, are repayable over the period from December 1, 1973 to February 1, 1974. The company may prepay any note. Reference is made to note 8(a).

The notes are convertible in whole or in part, at the option of the noteholder into fully-paid and non-assessable shares of the company. \$35,000 of the notes are convertible at the price of \$0.90 per share and the remainder of the notes are convertible at \$0.60 per share. The conversion rights continue until the date of payment of the notes.

At a meeting on May 31, 1972, the directors approved the conversion of the \$14,850 non-interest bearing loans due to shareholders into 12% convertible notes, which notes are convertible at \$0.60 per share.

6. Share capital

200,000 shares have been reserved under the terms of a stock option plan for senior officers (150,000 shares) and key employees (50,000 shares) at an option price of \$1.00 per share. At March 31, 1972, an option on 15,000 shares had been granted to a senior officer of the company. At a meeting on April 6, 1972, the directors agreed to amend the option price under the plan to an amount equal to 90% of the market value of the shares on the date of granting the options. Accordingly, the option granted was cancelled and replaced by an option of 15,000 shares at an option price of \$0.405 (90% of \$0.45) and a further option on 15,000 shares was granted to an officer at the same option price. On May 31, 1972 the company granted options on 50,000 shares to two officers of the company and 45,000 shares to key employees at an option price of \$0.405. All of the share options are exercisable in the following percentages commencing with the date the option is granted:

	Percentage of original option exercisable
During the 1st year of option	33⅓ %
During the 2nd year of option	66⅔ %
During the 3rd year of option	100 %

The company has reserved the following unissued common shares:

For stock options	200,000 shares
For 12% convertible notes payable (note 5) —	
At March 31, 1972	275,500 shares
Subsequent to March 31, 1972 (note 5)	24,750 shares
For minority interest in subsidiary (note 7(b))	4,160 shares
	<u>504,410 shares</u>

7. Commitments

At March 31, 1972 the company:

- (a) had a commitment under a premises lease to pay rent at an annual rate of approximately \$30,000 up to November 30, 1979; and
- (b) had an agreement with certain shareholders to purchase the balance of the shares of the partially-owned subsidiary for \$12,480, when and if these shareholders are able to acquire the shares. The agreement provides that the purchase price of \$12,480 is to be satisfied by the issue of 4,160 shares of Fathom or cash, at the option of the company.

8. Events subsequent to the year-end

- (a) In April 1972 the company completed negotiations (but not the final loan agreement) with the Ontario Development Corporation to obtain an 8% venture capital loan of \$100,000 and a 6½% export support loan of \$150,000. The venture capital loan is to be repayable over ten years in blended monthly payments of principal and interest of \$1,206. The export support loan is to provide funds to finance export sales and is repayable on demand.

The loans are to be secured by:

- chattel mortgage on all equipment and automobiles owned by the company,
- a floating charge on all other assets (except accounts receivable required to secure any bank loans),
- an assignment and postponement for ten years of 12% convertible notes outstanding at May 31, 1972 as described in note 5.
- an assignment of fire and Export Development Corporation Insurance policies,

— an assignment of specific accounts receivable related to sales financed under the export support loan programme.

The funds are to be advanced after the company's bankers release their security of the specific accounts receivable to be endorsed over to the Ontario Development Corporation and permit the chattel mortgage they presently hold on the equipment to be discharged. The company must also negotiate a satisfactory line of bank credit for domestic operating purposes.

- (b) Reference is made to note 5 for conversion of non-interest bearing note, and to note 6 for stock options issued after March 31, 1972.

9. Losses carried forward for income tax purposes

The company has incurred losses to March 31, 1972 totalling \$496,000 which can be carried forward for income tax purposes to be applied against any future income of the company within the time limits prescribed by law.

10. Statutory information

In accordance with Section 122.2 of the Canada Corporations Act 1970, it is reported that during the year there were nine directors (including three former directors) who received no remuneration as directors and eleven officers (including four former officers) who received \$78,890 as officers. During the year five directors were also officers.

11. Fixed assets

The comparative summary of fixed assets shown in the box below reflects a reduction in the cost in 1972 of the ship-ocean simulator by the grant received with respect to its construction as described in note 4(a). Reference is also made to notes 2 and 8(a).

	Original cost	Government grant (note 4(a))	Accumulated depreciation and amortization	Net book value	
				1972	1971
Equipment	\$ 43,665	—	\$15,831	\$27,834	\$27,038
Ship-ocean simulator	60,559	\$30,279	6,112	24,168	—
Automobiles	1,036	—	918	118	6,388
Leasehold improvements	24,900	—	5,769	19,131	22,004
Patterns and tooling	74,352	—	32,571	41,781	15,397
	<u>\$204,512</u>	<u>\$30,279</u>	<u>\$61,201</u>		
Total fixed assets				<u>\$113,032</u>	<u>\$70,827</u>

